# SERVICES AND ECONOMIC DEVELOPMENT

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It is widely agreed that when industrialization takes place the *share* of manufacturing or "secondary" products in total output increases, while the *share* of agricultural, mining, and similar, "primary", products declines. It is also claimed that at a later "stage" of development the *share* of services (or "tertiary" industries) in national income and total labour force tends to rise rapidly with increases in per capita income. In other words, as the economy develops the manufacturing sector "overtakes" agriculture and mining, and is in turn "overtaken" by services. This is sometimes known as the (Fisher-Clark) "stage" theory of development. The present article concerns the third "stage" - the growth of services - and its implications both for the developed and the developing countries.

A tendency for the share of different sectors of the economy to change over time had been detected by some economic thinkers in the past, notably Sir William Petty and Friedrich List. In 1858, Engel, by using some statistical figures for the state of Saxony showed that, broadly speaking, an increase in per capita income - beyond a certain "minimum" level - will raise the consumption of food *less than proportionately* and that of manufactured goods *more than proportionately*. In economic jargon, the income-elasticity of demand for food was found to be less and that for manufactured products more than unity. This would naturally give rise to a transfer of resources from agriculture into manufacturing, thus increasing (reducing) the share of manufacturing (agriculture) in national income and the total labour force. Other factors such as a higher rate of mechanization and exploitation of new techniques in manufacturing (resulting in a greater rate of increase in productivity than in agriculture) may further induce the decline of agriculture. And of course there is foreign trade. The decline in food production need not lead to starvation. Indeed, it would be beneficial to the country to concentrate her resources in the production of manufactured products, if her costs of producing food were comparatively greater than others.She would then sell industrial products and buy food in the international market.

Neither international specialization nor differences in mechanization and productivity growth rates can substantially explain the increase in the share of the service sector in national income, at the expense of the other two sectors. It is true that specialization in some services such as shipping, international banking and insurance, tourism etc., may and indeed has taken place in some countries. But most services cannot be "exported" or "imported". About the rate of growth of productivity in services as compared with, say, that of manufacturing we know very little, and it is dangerous to generalise. Raymond Aron believes that the rate of technical progress "is faster in the secondary sector,slower in the primary sector.... and even slower, occasionally nonexistent, in the tertiary sector". If this were true it might, perhaps, explain the increase in the labour force employed by services, and not its growing share of the output. But in fact there is little justification for this belief. Numerical studies by Phoebus J. Dhrymes and Victor R. Fuchs, for example, have rejected significant differences between these sectors with respect to productivity changes.

Thus there has been a tendency to explain the expansion of services, beyond a certain "stage", solely with reference to demand. When our "basic" material needs are satisfied - argued Professor Allan Fisher and Dr. Colin Clark in the 'thirties - our demand for services grows more than proportionately as our per capita income increases. Hence a reallocation of economic resources in favour of the service industries and an increase in this sector's share in national income and total labour force. Unfortunately, upon further examination even this explanation begins to flounder, and particularly two important problems suggest themselves:firstly recent statistical studies of the changes in demand for services seem to contradict the view that it increases by a greater percentage than the increase in income; and, secondly, that in the underdeveloped countries of the world the share of services in the national income (and total labour force) is already quite considerable, ranging roughly from 20 to over 40 per cent![1]

The first problem seems to arise mainly because what we generally call services are far more heterogeneous than are manufactured and agricultural products. Banking, transport, commerce, trade and education are all service industries, but there is no reason to believe that our demand for each of these services should increase proportionately more than the rise in our income. On these grounds it may be more fruitful if we divided the service sector into three categories of New, Old and Complementary Services.

New Services consist of such items as restaurants, cinemas, hotels, modern medical and clinical services, mass education and the like. This group of services has been labelled *new* not because they are necessarily assumed to be of recent discovery but because their consumption has in recent decades increased enormously in the advanced economies. Historically, the demand for such services varied no doubt with the growth and decline of populations, changes in per capita incomes, state of scientific knowledge etc., but in our age of relative abundance this increase has assumed considerable dimensions. The demand for these services is highly sensitive not only to the growth of per capita incomes but also to the increase in the leisure time of the mass of the people. As incomes grow and leisure time becomes more readily available people tend to spend more and more on travel, entertainment media and so on.

Complementary services include banking, finance, transportation, wholesale and retail trade activities which expand at a very fast rate with the rise of manufacturing production. These services have been complementary to the growth of industrial output in two ways: as complementary factors to urbanization, and as intermediate links connecting various institutions and sections of the national as well as the international markets. The growing demand for labour in industrial centres attracted people to urban areas, and factory production necessitated a high degree of urbanization.

At the same time the increase in division of labour and the use of more capital and intermediate products in industrial production - which tended to convert local markets into a unified national market, and expand foreign trade - called for an expansion of some of these services. Hence, as the rate of growth of industrial production increased so did the rate of growth of these services, and vice versa.

Government provides a particularly heterogeneous bundle of services and so deserves a special note. Some of the services it provides - such as education and health facilities- are really components of new services, while other government services, like bureaucratic activities etc., whose provision increases sharply with the growth of an industrial and urban society, belong to the group of complementary services. On the whole it is difficult to generalise about the share of government in services as it varies from period to period and country to country, and it is not uniquely determined by economic factors.

Old services include such service activities as used to flourish before industrialization, and whose importance and contribution has almost continuously declined. Domestic service is the most obvious example in this case, but it is not the only one. Most of the services in this group have been replaced by new or complementary services in addition to manufactured labour-saving devices, e.g. home appliances. For example, the services of stable-keepers, cab-drivers, etc., have been systematically replaced by those of garage mechanics and modern transport workers, servants by kitchen appliances (and restaurant services), and traditional entertainment by cinema, television and similar new services.

In short, new services expand with increases in income and leisure-time, while old and complementary services decline and rise primarily with the emergence and the growth of industrial production. Therefore a change in the share of total services in output and employment is the result of a change in the share of any, or all, of these three groups of services. Once the old services have almost completely disappeared from the scene, there should be a tendency for an even more rapid growth of the service sector than has been witnessed, in response to increases in income, leisure and complexity of industrial production.

Let us now trun our attention to the second problem. If it is true that service activities generally increase after a certain degree of industrial expansion, why then is the share of this sector quite considerable in the national product and total labour force of the developing countries? Two broad answers can be given to this question. Firstly, there is no reason why we should believe that the conditions existing in the poor countries should exactly match the situation in European countries before industrialization. Secondly one has to keep in mind that the developing countries of today live side by side with advanced, industrial, societies from which they are bound to adopt certain patterns of consumption expenditure, as well as productive techniques.

Take for example the extent of state activities in poor countries which is considerably greater than it ever waswhen most European countries began to develop. There may be historical as well as contemporary reasons for this.For example, the Marx-Wittfogel theory of Oriental Despotism - according to which shortage of water, and similar agricultural problems, had for a long time necessitated the concentration of power and activity in the centre - may partly explain the large bureaucratic apparatus in some Asian, North African and Latin American countries. Be that as it may, there is a considerable amount of pressure, both from within and from without, for the state to provide a certain amount of education and welfare services. In addition, the bureaucracy and the army is relatively large and costly for reasons that are not always, or predominantly, economic in nature. In some cases a considerable percentage of government employees are actually redundant, while some layers receive relatively exorbitant payments in cash and in kind. This is due to a mixture of traditional privileges and modern monopolistic tendencies arising from the relative shortage of skilled labour in these countries.

Underemployment of labour can also be found in small retailing and repair activities. For these activities the initial capital required is negligible, and - where extended family systems still survive - it is still customary to take almost every member of the family into business whether they are useful or not.

Wholesaling and merchant trade is on the other hand still the most flourishing "capitalist" activity in some of these countries, where there is a strong tradition,and where through the lack of long term entrepreneurial horizons and incentives,commercial capital is slow at being converted into fixed investment.

In addition to these factors while the share of old services is for obvious reasons relatively large, the share of new services is increasing. People of these countries - and particularly the well-to-do - are not going to "wait" for the country to develop before they begin to enjoy cinema, television, restaurants, clubs or to suffer a modern medical operation.

Finally, the growth of tourism is of special interest, since it has induced a great deal of catering development in some underdeveloped countries. However one should note that the expansion of this "new" service in some *poor* countries is due to the growth of income and leisure time in advanced societies.

It is not impossible for developing countries to produce roughly the same pattern of development once their industrialization efforts begin to bear real fruit. Old services will decline, and a redistribution of income from *sentiers* to profit-earners may actually halt the rapid increase in the consumption of the new services, while most complementary services are already quite extensive. It remains for the state to become more efficient and the army less costly. But this is anybody's guess.

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